

# California Prison Industry Authority

## Report to the Legislature Fiscal Year 2008-2009



Producing Results & Reducing Recidivism

The California Prison Industry Authority's (CALPIA) Fiscal Year 2008-09 Report to the Legislature is submitted pursuant to Chapter 1549, Statutes of 1982 as embodied in paragraph 2808 (k) of the California Penal Code.



Arnold Schwarzenegger  
Governor  
State of California

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# California Prison Industry Authority

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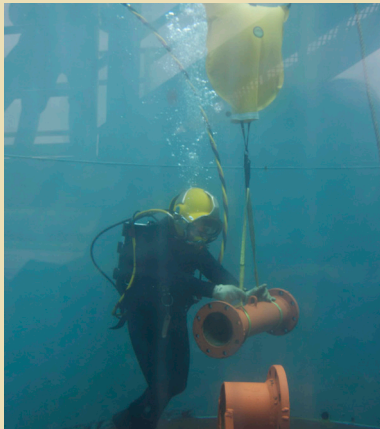
Charles L. Pattillo, Executive Officer

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## California Prison Industry Authority

### Producing Results



### Job Skills Earned

while incarcerated are proven to increase the possibility of reintegration into society and reduce recidivism

The California Prison Industry Authority's (CALPIA) Fiscal Year 2008-09 Report to the Legislature is submitted pursuant to Chapter 1549, Statutes of 1982 as embodied in paragraph 2808 (k) of the California Penal Code.

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## California Prison Industry Authority

### The Penal Code established CALPIA to:

- Develop and operate manufacturing, agricultural, and service enterprises that provide work opportunities for inmates under the jurisdiction of California Department of Corrections and Rehabilitation (CDCR), and serve governmental agencies with products and services commensurate with their needs.
- Create and maintain working conditions within enterprises, as much like those which prevail in private industry as possible, to assure inmates assigned therein the opportunity to work productively to earn funds, and to acquire or improve effective work habits or occupational skills.
- Operate work programs for inmates that are self-supporting through the generation of sufficient funds from the sale of products and services to pay all its expenses, thereby avoiding the cost of alternative inmate programming by CDCR.

### CALPIA Saves Taxpayers Money

- Former inmates who participated in CALPIA programs are less likely to return to prison than general population inmates. They are significantly more likely to become productive workers that pay taxes instead of costing California taxpayers approximately \$49,000 per year<sup>1</sup>.
- CALPIA's programs provide employers with a trained workforce. Many former CALPIA inmates receive industry accredited certifications that employers want, through partnerships with community support groups they are more likely to transition back into their community.
- CALPIA provides the state's prison system with an effective safety management tool that reduces prison violence.



CALPIA programs save tax dollars by reducing recidivism

1. Legislative Analyst's Office (March 2009) Report to Senate Budget Sub No.4.

## CALPIA Reduces Recidivism

### CALPIA Reduces Recidivism & Saves Money

A tool we use to measure our success is to review our recidivism rate. Over a three year period, beginning in FY 2005-06, CALPIA parolees return to prison on average 22 to 30 percent less often than CDCR general population parolees. This is highlighted in the chart below comparing CDCR's and CALPIA's recidivism rates.

Table 1: The following table shows the one, two and three year recidivism rates for CALPIA inmate workers and for CDCR General Population parolees (as reported September 2009 by the CDCR Office of Research ), and the variance percentages associated with each.

|                  | CALPIA                      | CDCR                        | CALPIA  | CDCR      | VAR*    | CALPIA           | CDCR      | VAR*    | CALPIA  | CDCR             | VAR*    |        |
|------------------|-----------------------------|-----------------------------|---------|-----------|---------|------------------|-----------|---------|---------|------------------|---------|--------|
| Fiscal<br>Year   | Total number<br>of parolees | Total number<br>of parolees | 1 year  | 1 year    | 1 year  | 2 year           | 2 year    | 2 year  | 3 year  | 3 year           | 3 year  |        |
|                  |                             |                             | Percent | Percent** | Percent | Percent          | Percent** | Percent | Percent | Percent**        | Percent |        |
| 07/08            | 1,637                       | 116,497                     | 31.83%  | 42.18%    | 24.54%  | 39.71%           |           |         |         |                  |         |        |
| 06/07            | 1,853                       | 115,522                     | 30.87%  | 43.20%    | 28.54%  | 43.34%           | 55.83%    | 22.39%  | 44.41%  |                  |         |        |
| 05/06            | 1,822                       | 108,637                     | 32.44%  | 44.92%    | 27.80%  | 43.19%           | 58.77%    | 26.50%  | 43.63%  | 62.51%           | 30.20%  |        |
| Average Variance |                             |                             |         |           | 26.95%  | Average Variance |           |         | 22.39%  | Average Variance |         | 30.20% |

Using FY 2007-08, CALPIA employed about 6,800 inmate workers and had a parole population of 1,637 parolees. Of the 1,637 parolees, 521 (31.83%) returned to custody within one year. Of the 521 CALPIA parolees, 148 (28.41%) inmates returned with new terms and 373 (71.59%) returned to custody on parole violations. The remaining 1,116 parolees stayed out of the criminal justice system in that year.

Using a CDCR-wide recidivism rate of 42.18%, we would have expected 690 of the same population to reoffend, within the first year, a difference of an additional 169 re-offenders than CALPIA.

Of the 169 re-offenders, 48 (28.14%) returned on a parole violation with a new term at an estimated cost of \$2.3 million for incarceration and \$1.9 million for judicial costs. Depending on the length of the new term, the remaining 121 (71.59%) inmates returned to custody at an estimated cost of \$2.4 to \$3.5 million.

When the cost of incarceration and prosecution of these 169 is added to the nearly \$1.3 million cost to local law enforcement, it is conservatively estimated that CALPIA saves taxpayers up to \$9 million annually due to lower recidivism.

## California Prison Industry Authority

CALPIA is a self-supporting, customer-focused business that provides productive work, training, and skill development opportunities which reduce the recidivism of CDCR inmates.



CALPIA rehabilitates inmates through job training, which leads to employment opportunities upon release.

## California Prison Industry Authority

CALPIA manages 60 manufacturing, service and agriculture industries in 23 institutions providing employment and programming for approximately 6,800 inmates at California's penal institutions with CDCR. Administrative offices are located in Folsom, California.

### Products and Services

CALPIA is self-supporting through the sales of its products and services primarily to the State of California departments and receives no General Fund appropriation from the Legislature. CALPIA spends its revenue dollars to cover the cost of raw materials, inmate supervision, inmate payroll, transportation and distribution, capital acquisition, debt reduction, expansion, and central office administration. Any profits that CALPIA achieves are reinvested into the organization to expand into new business, invest in vocational education, modernize existing enterprises or upgrade State facilities and fund other post employment benefits as required by law.

### Program Goal

Our program goal: to produce CALPIA trained inmates that will have not only a job skill, good work habits, and basic education, but also job support in the community when they parole.

By being economically self-supporting, CALPIA reduces CDCR inmate programming costs.

### What's New at CALPIA

#### California Assistive Technologies Enterprise (CATE)

CALPIA will fund and administer CATE at Folsom State Prison to benefit blind, visually and hearing impaired members of the community.

Products and services provided by CATE will include:

- Braille Transcription
- ADA Compliant Websites
- Aural Media/Recordings
- Post Production Closed Captioning

### California Prison Industry Authority

#### What's New at CALPIA

Due to the state's ongoing fiscal crisis and reductions to CDCR's vocational education programs, CALPIA will fully fund the Career Technical Education (CTE) program. Previously, this program was funded through an agreement with CDCR and administered by CALPIA. Since its inception, the CTE programs run by CALPIA have had a combined recidivism rate of approximately 10 percent.

CALPIA's CTE programs provide opportunities for over 370 inmates per year in seven different CTE programs. Certifications in transferable skills ranging from commercial diving and underwater construction to carpentry pre-apprenticeship training programs are offered. Upon completion of the training, paroling inmates are eligible for placement in a full-scale apprenticeship program.

The CTE program not only provides training in technical skills, but also instills a professional attitude of determination, perseverance, and courage. Together, these skills provide graduates with more than just employment opportunities, they provide parolees opportunities that are proven to reduce recidivism rates.

In partnership with CALPIA, the Northern California Carpenters Regional Council, the International Association of Bridge, Structural, Ornamental and Reinforcing Ironworkers, and the Northern California District Council of Laborers allow paroled CTE Graduates to be eligible for placement in pre-apprenticeship jobs.



CALPIA's CTE Programs have a recidivism rate of approximately 10 percent.

### California Prison Industry Authority

#### **Marine Technology Training Center (MTTC)**

CALPIA operates the Leonard Greenstone Marine Technology Training Center (MTTC). This 18-month program provides training in diverse curriculum including diving physics, navigation, welding, blueprint reading, diesel engines, and marine construction. MTTC graduates meet the standards required by the U.S. Coast Guard, the United States Department of Labor, OSHA Occupational Safety and Health Administration, and the Association of Diving Contractors International. The MTTC works closely with representatives in the underwater construction industry to ensure the program's graduates secure jobs after release.

#### **Career Technical Education – Pre-Apprenticeship Programs Carpentry / Ironworking / General Laborer**




In 2009, 121 inmates graduated with pre-apprenticeship program diplomas. The pre-apprenticeship programs have successfully delivered several projects assisting with design development, architecture and engineering, project management and oversight. By offsetting expenses, and providing only the funding required for specialty contracts and building materials, the host institution can accomplish projects that may otherwise be cost prohibitive.

#### **Career Technical Education – Modular Building Enterprise (MBE)**

CALPIA opened its first 30,000 square foot modular building manufacturing facility at Folsom State Prison in 2006. The facility is International Standards Organization 9001 certified and produces modular buildings with thirty-year life spans as opposed to the typical seven year life of the average modular building. The MBE is capable of producing up to 400 square feet of manufactured building on a daily basis, seven days per week. Inmates enrolled in the MBE are trained in the practice and theory of pre-apprenticeship carpentry, ironworking, and labor, with the option to receive certifications in welding and network cabling.

## California Prison Industry Authority



-  CALPIA is committed to gaining expertise to promote principles of sustainability in our operations, our practice, and our products.
-  By searching out and applying sustainability in practices we endeavor to reduce our environmental load.
-  CALPIA complies with all safety and environmental regulations and continuously works to improve environmental performance.



### California Prison Industry Authority



CALPIA is responsive to its customers, produces quality products at competitive prices, and saves taxpayers money by reducing the State's recidivism rate through productive inmate work assignments and effective training. CALPIA work assignments are also a valuable inmate management tool that increases prison safety.

The new California Green product line provides our customers with both a biodegradable glass cleaner and multipurpose surface cleaner. Additionally, CALPIA distributes the California Green cleaner dispenser to further reduce waste, saving our customers money.

#### **California Green**

Glass Cleaner Concentrate

- Environmentally preferable glass cleaner
- Biodegradable formula does not contain harsh polluting or toxic chemicals
- Cleans quickly and does not streak, smear or smudge

#### **California Green**

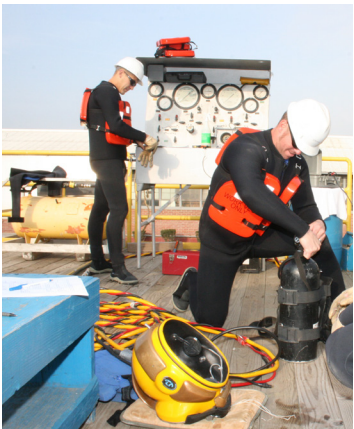
Multipurpose Cleaner Concentrate

- Biodegradable and does not contain harsh or toxic chemicals
- Superior cleaning performance on numerous surfaces
- Leaves no alkaline residue, even in hard water conditions

CALPIA is offering a new line of environmentally responsible cleaning products

## Inmate Employability Program

### California Prison Industry Authority



#### Inmate Employability Program

CALPIA supports CDCR's rehabilitation mission through job training, which leads to employment opportunities for parolees upon release. In 2002, to enhance the employability of inmates, CALPIA created the Inmate Employability Program, which uses CALPIA factories and enterprises as the foundation for skill development, facilitates program development and industry accredited certification for inmates' successful reentry back into society. CALPIA enterprises currently meet 15 out of the top 50 projected occupational openings for 2006 to 2016, per the Employment Development Department, California Labor Market statistics. Within the FY 2008-09, CALPIA provided 370 industry accredited certifications, graduated 121 Career Technical Education inmates with certifications in carpentry, ironworking, and general labor, graduated 9 inmates from Marine Technology Training Center, and provided over 1,700 additional inmates with Certificates of Proficiency based on meeting criteria of the Standard Operational Codes.

### California Prison Industry Authority

#### **CALPIA Identification Pilot**

CALPIA implemented and continues to provide the only California Identification Pilot to parolees in California through the agreements with the California Department of Motor Vehicles at four institutions. Since its inception in September 2008, over 285 inmates have participated in the program, of which 128 parolees (44 %) have purchased their California identification or driver license, at no cost to CDCR or CALPIA, and received them at the gates upon release. Of the 128 parolees with less than a year's recidivism data gathered to date, only five (3.9 %) have returned to custody.

#### **Transition to Employment Program**

CALPIA recognizes that for inmates to have a better chance to succeed once paroled, they need an additional support system. In FY 2008-09 CALPIA was selected by the National Correctional Industries Association to be a member of one of the first all correctional industry teams (from 12 states) to participate in the National Institute of Corrections and the National Career Development Association, Offender Workforce Development Specialist Partnership Training Program. The training was developed to provide participants with the skills needed to assist offenders with career planning, job placement, job retention, and career advancement. The correctional team will develop a program model that can be implemented within the institutional settings prior to parole.

### California Prison Industry Authority

#### Contributes to Victim Assistance

The Joint/Free Venture Program contributed \$111,287 to victim assistance groups for FY 2008.

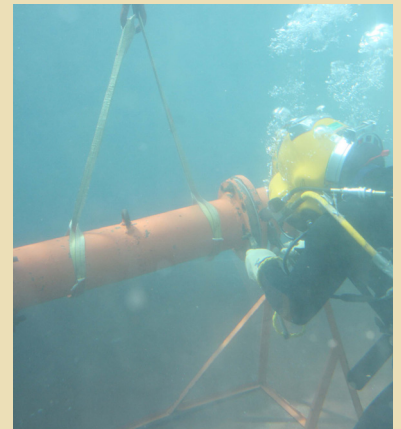
The CDCR's Joint/Free Venture Program is managed by CALPIA. These programs offer valuable benefits to business owners across the State while providing productive work experience for the California youthful offender population. These programs involve a working relationship between the public sector and private industry. The industry sets up and operates its business within the confines of the correctional facility and hires motivated inmate/ward workers as its employees at industry comparable wages. The inmate/wards receive training for meaningful jobs, subsequently aiding their successful community placement. Major benefits of this program are deductions for victim restitution, repayment of CDCR room and board, tax incentives to the business owner and decreasing State costs.

#### Program Benefits

- Inmates/wards develop sound work habits, gaining job experience and references
- Decreased problems associated with inmate/ward idleness
- Offenders return to society as well trained, motivated individuals with savings and skills, decreasing the level of crime in the community
- The Joint/Free Venture Program contributed \$111,287 to victim assistance groups in FY 2008-09
- Combining payroll taxes, room and board payments, and victim compensation, the Joint/Free Venture Program ward/inmate employees have returned over \$12,078,330 million to public since July 1991

The Joint Venture Program was established in 1990 upon the passage of Proposition 139 the Prison Inmate Labor Initiative.

## California Prison Industry Authority



### Learning Job Skills

prepare inmates for  
successful transition  
back into society

CALPIA supports the CDCR's mission to promote public safety through effective rehabilitation and, in terms of recidivism reduction, is among CDCR's most successful programs.

# Industry Accreditations

## Creating a Ready Workforce

### American Board of Opticianry

Optician

### American Institute of Baking

Type: Science of Baking

Bread/Rolls

Cake/Sweet Goods

Foundations

Ingredient Technician

### American Welding Society

Type: **Mig**

Gas Metal Arc Welding (GMAW) -1

Type: **Tig**

Gas Tungsten Arc Welding (GTAW) -1

Gas Tungsten Arc Welding (GTAW) -2

Gas Tungsten Arc Welding (GTAW) -3

### CAL Dept of Food & AG

Pasteurizer License

Sampler/Weigher License

### CAL Dept of Health Services

Final Inspector

### Electronics Technicians Association

Customer Service Specialist

Certified Electronics Technician

Industrial Journeyman

Federal Communication Control

### Hyster

Forklift Operator Certification

### Association for Linen Management

Certified Linen Technician

Certified Washroom Technician

Certified Laundry Linen Manager

### National Institute of Metalworking Skills

Machining, Level I

Metal Forming, Level I

Metal Stamping, Level II

### National Restaurant Association

ServSafe Essentials

ServSafe Employee Guide

### North American Technician Excellence

|            | Installation | Service    |
|------------|--------------|------------|
| HVAC Type: | A/C          | A/C        |
|            | Air Dist.    | Air Dist.  |
|            | Heat Pumps   | Heat Pumps |
|            | Gas Heat     | Gas Heat   |
|            | Oil Heat     | Oil Heat   |

### Printing Industries of America

Sheetfed Offset Press

Web Offset Press

Bindery

### Productivity Training Corporation

Dental Technician

### Stiles Machinery Inc.

Intermediate Weeke Machining

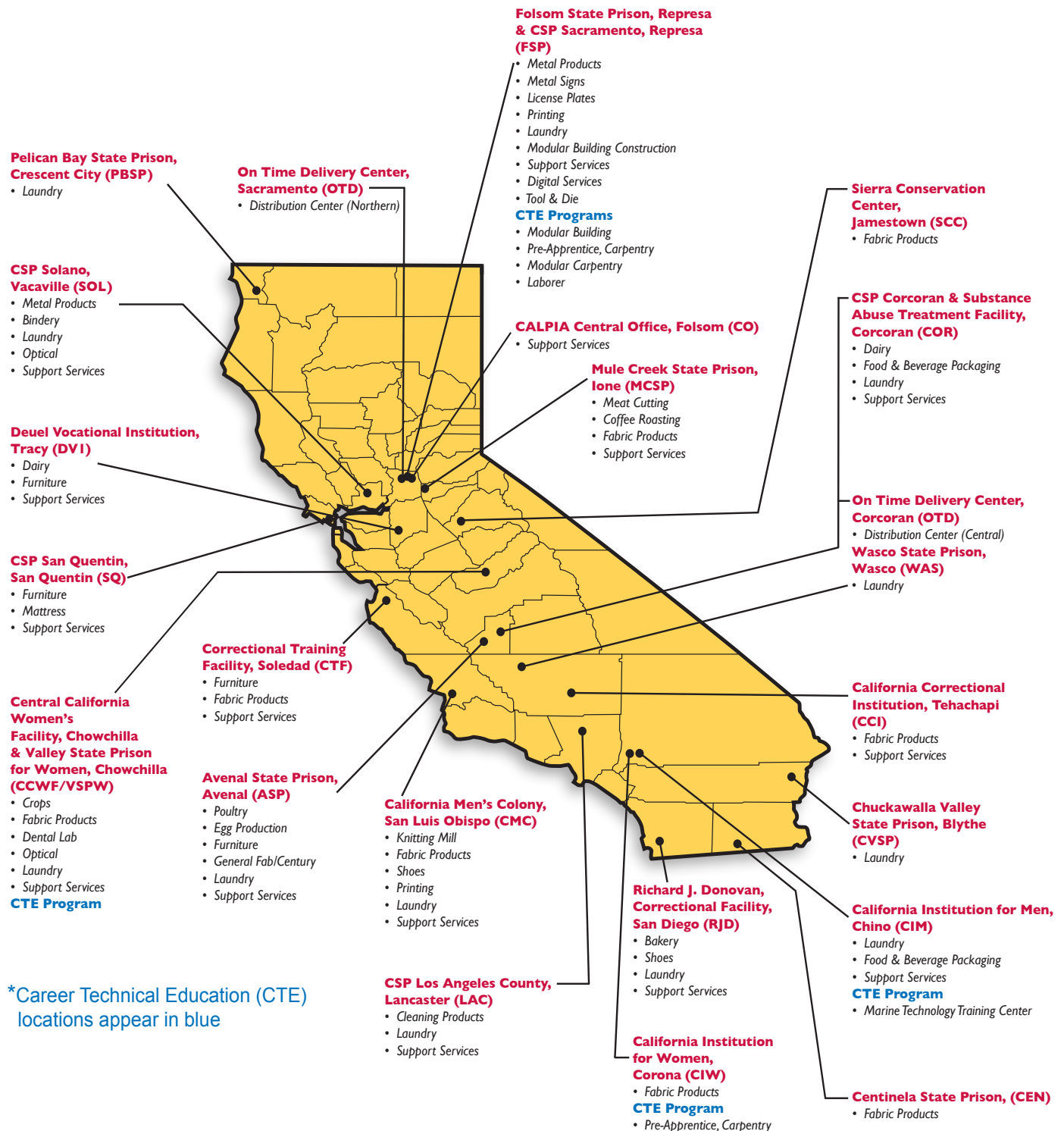
Center Programing

### Select Stiles Breeding Corporation

Artificial Insemination License



# CALPIA Enterprises and Career Technical Education Locations (CTE)\*



## Sales and Expenses

| Sales (In Thousands)  | FY 2007-08<br>Actuals Audited | FY 2008-09<br>Actuals Audited |
|---|-------------------------------|-------------------------------|
| Manufacturing   | \$106,629                     | \$123,185                     |
| Services  | 71,658                        | 80,326                        |
| Agricultural  | 31,245                        | 30,722                        |
| Total Revenue   | \$209,532                     | \$234,233                     |
| <b>Expenses (In Thousands)</b>                                |                               |                               |
| Cost of Goods Sold  |                               |                               |
| Manufacturing   | \$86,367                      | \$101,745                     |
| Services  | 53,572                        | 55,078                        |
| Agricultural  | 30,507                        | 29,481                        |
| Total Cost of Goods Sold                                      | \$170,446                     | \$186,304                     |
| <b>Gross Profit</b>   | <b>\$39,086</b>               | <b>\$47,929</b>               |
| <b>Selling &amp; Administration Expenses (In Thousands)</b>   |                               |                               |
| Distribution/Transportation                                   | \$15,553                      | \$13,727                      |
| Central Office  | 20,421                        | 21,092                        |
| <b>Post Employment Benefit-other than pension<sup>1</sup></b> | <b>6,637</b>                  | <b>6,001</b>                  |
| Total Selling & Administration Expenses                       | \$42,611                      | \$40,820                      |
| <b>Operating Income/(Loss)</b>                                | <b>(\$3,525)</b>              | <b>\$7,109</b>                |
| Non-Operating Revenues/(Expenses)                             | <b>\$571</b>                  | <b>(\$150)</b>                |
| <b>Net Gain (Loss)<sup>1</sup></b>                            | <b>(\$2,954)</b>              | <b>\$6,959</b>                |

<sup>1</sup>Pursuant to Governmental Accounting Standards Board Statement 45-- *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions (OPEB)*—beginning with fiscal year 2007-08, CALPIA is required to recognize the cost of unfunded actuarial accrued liabilities for retiree health benefit programs. This amount is determined by the State Controller's Office. Refer to independent audit report, footnote (9). CALPIA is one of only two state entities that must actually fund this expenditure. State agencies are allowed to footnote the liability without providing actual funds. If not for this liability, CALPIA would have recognized a \$3,112 million net profit in 2007/2008.

## Sales by Enterprise

| Enterprise                | FY 2007-08           | FY 2008-09           |
|---------------------------|----------------------|----------------------|
| <b>Manufacturing</b>      |                      |                      |
| Metal Products            | \$6,404,143          | \$3,908,571          |
| License Plates            | 13,559,436           | 10,904,074           |
| General Fabrication       | 12,754,302           | 17,226,231           |
| Bindery                   | 2,959,896            | 3,636,349            |
| Knitting Mill             | 2,055,710            | 1,785,709            |
| Fabric Products           | 26,918,554           | 26,587,532           |
| Silk Screen               | 73,352               | 54,242               |
| Shoes                     | 4,497,770            | 5,450,382            |
| Mattresses                | 2,932,994            | 2,598,543            |
| Cleaning Products         | 3,767,089            | 6,157,438            |
| Modular Construction      | 5,938,451            | 25,328,947           |
| Furniture                 | 24,767,204           | 19,547,224           |
|                           | <b>\$106,628,901</b> | <b>\$123,185,240</b> |
| <b>Services</b>           |                      |                      |
| Meat Cutting              | 10,677,467           | \$10,792,831         |
| Bakery                    | 2,759,052            | 3,442,818            |
| Coffee Roasting           | 1,539,216            | 2,305,585            |
| Digital Services          | 0                    | 5,766                |
| Food & Beverage Packaging | 11,198,080           | 16,120,041           |
| Metal Signs               | 1,115,772            | 1,324,069            |
| Printing                  | 7,468,526            | 7,573,647            |
| Dental Lab                | 520,381              | 607,289              |
| Laundry                   | 15,392,253           | 16,665,143           |
| Optical                   | 20,986,880           | 21,488,391           |
|                           | <b>\$71,657,627</b>  | <b>\$80,325,580</b>  |
| <b>Agricultural</b>       |                      |                      |
| Dairy/Farm                | 15,456,923           | 15,193,773           |
| Crops                     | 1,470,246            | 1,341,100            |
| Poultry                   | 6,290,546            | 6,746,286            |
| Egg Production            | 8,027,517            | 7,441,017            |
|                           | <b>\$31,245,232</b>  | <b>\$30,722,176</b>  |
| <b>Total</b>              | <b>\$209,531,760</b> | <b>\$234,232,998</b> |

## Inmate Labor by Location

| Location  | Average Monthly Filled Inmate Assignments |              |
|---|---|--------------|
|   | FY 2007-08                                | FY 2008-09   |
| California Institution for Men                                    | 244                                       | 202          |
| California Men's Colony   | 724                                       | 664          |
| R.J. Donovan Correctional Facility                                | 418                                       | 428          |
| Correctional Training Facility                                    | 622                                       | 592          |
| Avenal State Prison   | 584                                       | 553          |
| Deuel Vocational Institution                                      | 257                                       | 251          |
| Folsom State Prison/CSP Sacramento                                | 569                                       | 682          |
| San Quentin State Prison  | 302                                       | 323          |
| California Institution for Women                                  | 145                                       | 158          |
| California Correctional Institution                               | 277                                       | 305          |
| California State Prison, Solano                                   | 613                                       | 657          |
| Mule Creek State Prison   | 382                                       | 387          |
| Corcoran State Prison/Substance Abuse Treatment Facility          | 580                                       | 495          |
| Chuckawalla Valley State Prison                                   | 54  | 58           |
| Pelican Bay State Prison  | 96  | 120          |
| Sierra Conservation Center  | 150                                       | 131          |
| Central California Women's Facility/Valley State Prison for Women | 433                                       | 438          |
| California State Prison, Lancaster                                | 101                                       | 99           |
| Wasco State Prison  | 83  | 76           |
| Centinela State Prison  | 0   | 74           |
| On Time Delivery, North   | 28  | 4            |
| On Time Delivery, Central   | 12  | 21           |
| On Time Delivery, South   | 7   | 0            |
| Central Office  | 42  | 32           |
| <b>Total</b>  | <b>6,858</b>                              | <b>6,829</b> |

**CALIFORNIA PRISON INDUSTRY AUTHORITY**

(A Component Unit of the  
State of California)

**ANNUAL FINANCIAL REPORT**

Years Ended June 30, 2009 and 2008

**CALIFORNIA PRISON INDUSTRY AUTHORITY**  
(A Component Unit of the State of California)

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**OAKLAND**

**LOS ANGELES**

**NEWPORT BEACH**

**SAN DIEGO**

## **INDEPENDENT AUDITOR'S REPORT**

To the California Prison Industry Authority Board  
Folsom, California

We have audited the balance sheet of California Prison Industry Authority ("CALPIA"), a component unit of the State of California, as of June 30, 2009 and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of CALPIA's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of CALPIA as of and for the year ended June 30, 2008, were audited by other auditors whose report dated December 4, 2008, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of CALPIA's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CALPIA as of June 30, 2009 and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 1, 2009 on our consideration of CALPIA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and important for assessing the results of our audit.

The management's discussion and analysis on pages 3 through 11 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

*Maciel Gini & O'Connell LLP*

Sacramento, California  
December 1, 2009

**CALIFORNIA PRISON INDUSTRY AUTHORITY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
AS OF AND FOR THE YEARS ENDED JUNE 30, 2009 AND 2008 (Unaudited)**

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**INTRODUCTION – CALIFORNIA PRISON INDUSTRY AUTHORITY**

The following Management Discussion and Analysis (“MD&A”) applies only to the activities of the California Prison Industry Authority (“CALPIA”) and should be read in conjunction with the basic financial statements and related footnotes.

CALPIA is a proprietary component unit of the State of California (State) and is accounted for in the Prison Industries Revolving Fund, which is an internal service fund in the State’s basic financial statements. CALPIA does not receive a State appropriation.

Chapter 1549, Statutes of 1982, created CALPIA as a semi-autonomous state agency. The statutory purposes of the CALPIA are to:

- Develop and operate manufacturing, agricultural, and service enterprises that provide work opportunities for inmates under the jurisdiction of the California Department of Corrections and Rehabilitation (“CDCR”);
- Create and maintain working conditions within enterprises, as much like those which prevail in private industry as possible, to assure inmates the opportunity to work productively to earn wages, and to acquire or improve effective work habits or occupational skills;
- Operate a work program for inmates that is self-supporting through the sale of products and services and reduces the cost of operation of the CDCR.

CALPIA is under the policy direction of an eleven-member board of directors, which reviews and approves the annual budget for the CALPIA. CALPIA manages over 60 manufacturing, service, and agricultural factories in 23 institutions. Administrative offices are located in Folsom, California. The goods and services produced by CALPIA’s operations are sold principally to departments of the State of California and other governmental entities. CDCR is CALPIA’s largest customer and accounted for 61% and 56% of all sales in the years ended June 30, 2009 and 2008, respectively.

**Overview**

The mission statement of the CALPIA Strategic Business Plan (“Strategic Plan”) aptly defines CALPIA as a “self-supporting, customer-focused business that provides productive work, training, and skill development opportunities which reduce the recidivism of CDCR inmates.” The mission statement reflects CALPIA’s twofold purpose of providing inmate rehabilitation and operating a self-sufficient business. With respect to both these goals, fiscal year 2009 was a successful one for CALPIA.

## Overview (Continued)

Though economic times have been difficult, CALPIA has thrived by responding to customer demands and aggressively managing costs. In fiscal year 2009, CALPIA earned \$234.2 million of revenue, which exceeds the previous year's total by \$24.7 million (11.8%) and also marks the third successive year that CALPIA has recorded an all time high sales level. While achieving record sales levels, CALPIA reduced overall selling and administrative expenses by \$1.8 million (4.2%), inclusive of the effect of Governmental Accounting Standards Board (GASB) Statement No. 45 (GASB No. 45)—*Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions (OPEB)*.

Under GASB No. 45, beginning with fiscal year 2008, the State is required to recognize the cost of retiree health benefit programs on an accrual basis rather than on a pay as you go basis. In its role of administering GASB No. 45 on behalf of the State, the State Controller's Office informed CALPIA that its share of the State's net unfunded OPEB obligation for fiscal years 2009 and 2008 is \$6.0 million and \$6.6 million, respectively. CALPIA recorded these additional costs as a "selling and administrative" expense on the operating statement in addition to the actual payments made for OPEB. The State does not maintain a separate pool of assets to finance future retiree healthcare benefits. As one of the few state agencies required to fund the OPEB obligation from its own proprietary fund, CALPIA will actively monitor the costs of retiree health benefits in accordance with Generally Accepted Accounting Principles and the funding policies of the State.

Financially, fiscal year 2009 was unusual, albeit profitable, for CALPIA. Approximately half of CALPIA's enterprises endured decreases in sales from the prior year while the other half benefited from increased sales. Revenue decreases in license plates, metal products, and furniture were more than offset by revenue increases in cleaning products, modular buildings, and modular furniture. With respect to expenses, Governor Schwarzenegger ordered all State workers to take two days off per month without pay, effective February 2009, thereby creating a savings of more than \$1.5 million. (The Governor since added a third furlough day, commencing July 2009.) Additionally, CALPIA experienced a \$1.8 million decrease in freight costs through timely reductions in fuel prices combined with increased reliance on its own distribution system.

CALPIA's ongoing financial success would not be possible without an organization wide commitment to strategic planning and continuous improvement. In fiscal year 2009 CALPIA invested resources to update its Strategic Plan, which encompasses efforts to increase revenues and reduce costs, while improving the quality of products and services.

Enhanced communication between CALPIA and its customers has encouraged sales, particularly in the modular buildings and cleaning products enterprises, while monitoring raw material costs has resulted in appropriate pricing adjustments. Of particular importance, during the prior fiscal year, CALPIA upgraded manufacturing processes in the furniture and modular building factories to attain the ISO 9001:2000 standard, an international industrial standard for quality. CALPIA previously received ISO 9001:2000 certification in the general fabrication (modular furniture) factory. Achieving the ISO 9001:2000 standard affirms the quality of the products manufactured by CALPIA as well as the business practices that support them.

## Overview (Continued)

Programmatically, CALPIA takes pride in its unique contributions to state government. In fiscal year 2009, CALPIA employed more than 5,900 inmates per month in diverse manufacturing, service and agricultural enterprises. Through employing inmates, CALPIA promotes the safety of CDCR institutions by reducing inmate idleness and teaching social skills applicable to the work place. Beyond providing jobs, CALPIA invests in rehabilitation programs for inmates, including programs that offer vocational training and industry accredited certification skills ranging from optometry and dental technology to laundry, commercial baking, welding, and metal stamping. CALPIA also provides career technical education (CTE) in commercial underwater diving, carpentry, and ironworking in partnership with trade unions who offer employment possibilities when inmates are released on parole. In fiscal year 2009, seventeen hundred (1,700) inmates received certificates of proficiency in standard occupational disciplines. Another four hundred thirty-five (435) inmates successfully completed accredited certification programs. CDCR facilitates these efforts by reimbursing CALPIA for a substantial portion of its vocational and CTE program costs. Research indicates that the structure of CALPIA's programs, which combine manufacturing with education and training, is effective in helping inmates succeed when they are returned to the community. Recidivism rates among CALPIA inmate workers are 25% less than the recidivism rate of the general prison population. Among graduates of CALPIA's certification and apprenticeship programs, the recidivism rates are even lower.

CALPIA is proactively responding to challenges brought about by the prevailing climate of economic uncertainty. The 2009-10 Budget for the State of California eliminated the optical benefit for adult Medi-Cal recipients, the prescriptions for which had been filled at CALPIA's factories. As a result, CALPIA will close two optical factories during fiscal year 2010 whose combined contribution to CALPIA's gross profit is approximately \$4 million annually. Similarly, in response to reduced discretionary spending by all governmental agencies, CALPIA is deactivating two furniture factories in fiscal year 2010. In a separate cost effective measure, CALPIA is closing a dairy in fiscal year 2010, downsizing from three dairies to two.

Notwithstanding current retrenchment efforts, CALPIA recognizes that formidable challenges lie ahead. CALPIA expects a substantial reduction in revenues in fiscal year 2010. CDCR is also cutting expenditures in vocational programs, which will likely affect the amount of reimbursements CALPIA receives from this source. Moreover, how the State elects to fund the OPEB obligation and to what extent the State will continue mandatory worker "furlough" days are examples of two issues of great consequence to CALPIA. With respect to the latter, CALPIA's employees are among the majority of State workers who are required to take three unpaid "furlough" days per month. Though short-term cost savings are associated with furloughs, CALPIA is a defendant in a legal challenge which would exempt its workers from furloughs. CALPIA is preparing to fund the OPEB obligation as well as planning for an eventual outcome which would restore full salaries and wages to its workforce.

As our customers benefit from quality goods and services, so do our inmate workers and, ultimately, communities throughout California. In that spirit, CALPIA is dedicated to sustaining its long tradition of providing inmates with meaningful work experiences, training, and education in a fiscally responsible manner.

## Condensed Balance Sheet

The following table presents the condensed balance sheets for CALPIA as of June 30, 2009, 2008 and 2007:

|  | <u>2009</u>           | <u>2008</u>           | <u>2007</u>           |
|--|-----------------------|-----------------------|-----------------------|
| <b>Assets</b>                            |                       |                       |                       |
| Cash and cash equivalents                | \$ 44,059,867         | \$ 60,207,601         | \$ 29,906,734         |
| Accounts receivable                      | 11,258,815            | 13,713,014            | 14,379,156            |
| Due from state general fund              | 20,800,000            | -                     | -                     |
| Inventories                              | 49,114,484            | 55,832,218            | 50,751,224            |
| Capital assets, net                      | 50,307,712            | 52,552,900            | 53,628,563            |
| Other assets                             | 372,427               | 828,748               | 1,050,954             |
| Total assets                             | <u>\$ 175,913,305</u> | <u>\$ 183,134,481</u> | <u>\$ 149,716,631</u> |
| <b>Liabilities</b>                       |                       |                       |                       |
| Accounts payable and accrued liabilities | \$ 21,890,749         | \$ 24,178,207         | \$ 21,225,747         |
| Deferred revenue                         | 10,534,685            | 31,035,693            | 5,714,207             |
| Workers' compensation reserves           | 14,669,927            | 12,062,775            | 10,600,000            |
| Net OPEB Obligation                      | 12,638,000            | 6,637,000             | -                     |
| Total liabilities                        | <u>59,733,361</u>     | <u>73,913,675</u>     | <u>37,539,954</u>     |
| <b>Net Assets</b>                        |                       |                       |                       |
| Invested in capital assets               | 50,307,712            | 52,552,900            | 53,628,563            |
| Unrestricted net assets                  | 65,872,232            | 56,667,906            | 58,548,114            |
| Total net assets                         | <u>116,179,944</u>    | <u>109,220,806</u>    | <u>112,176,677</u>    |
| Total liabilities and net assets         | <u>\$ 175,913,305</u> | <u>\$ 183,134,481</u> | <u>\$ 149,716,631</u> |

## Assets

Total assets decreased by \$7.2 million at June 30, 2009 compared to June 30, 2008, which is explained by a \$16.1 million decrease in cash and cash equivalents, a \$6.7 million decrease in inventories, a \$2.2 million decrease in capital assets, a \$3.0 million combined decrease in accounts receivable and other assets, offset by a \$20.8 million increase in due from state general fund. Total assets increased by \$33.4 million at June 30, 2008 compared to June 30, 2007, which is explained by a \$30.3 million increase in cash and cash equivalents and a \$5.1 million increase in inventories offset by a \$1.1 million decrease in capital assets and a \$0.9 million combined decrease in accounts receivable and other assets.

### ***Assets (Continued)***

The \$16.1 million decrease in cash and cash equivalents at June 30, 2009 is explained by the positive cash flows from operating activities of \$11.0 million and investing activities of \$0.8 million, offset by the net outflow of \$20.8 million in a short-term loan to the state general fund and \$7.1 million from capital asset acquisitions and disposals.

The increase in due from state general fund at June 30, 2009 reflects a short-term loan authorized by the State Controller's Office for cash management purposes. The decrease in inventories is the result of utilizing on-hand inventories from the prior year to satisfy current year production demands, particularly in the furniture, license plates, and general fabrication enterprises. The decrease in capital assets is attributable to reduced capital outlays and, depreciation, as well as the disposal of older equipment.

The \$30.3 million increase in cash and cash equivalents at June 30, 2008 is explained by the positive cash flows from operating activities of \$37.6 million and non-capital financing and investing activities of \$0.7 million, offset by the net outflow of \$8.0 million from capital asset acquisitions and disposals. The most significant component of cash flows from operating activities is a \$25.0 million advance received from CDCR for modular office buildings.

The build-up in inventories at June 30, 2008 is the result of a concentrated effort to meet production demands, particularly in the general fabrication and modular building enterprises. The decrease in capital assets is due to depreciation and disposal of assets.

### ***Liabilities***

Total liabilities decreased by \$14.2 million at June 30, 2009 compared to June 30, 2008. This is mainly explained by a \$6.0 million increase in the liability for Other Post Employment Benefits (OPEB) offset by a \$20.5 million decrease in deferred revenue. Additionally, accounts payable decreased by \$2.3 million and workers' compensation reserves increased by \$2.6 million.

Total liabilities increased by \$36.4 million at June 30, 2008 compared to June 30, 2007. This increase is mainly explained by the recording of a \$6.6 million liability for Other Post Employment Benefits (OPEB) as well as a \$25.3 million increase in deferred revenue. In addition, accounts payable and accrued liabilities and workers' compensation reserves increased by \$3.0 million and \$1.5 million, respectively.

Similar to other proprietary funds, the State annually allocates a portion of retiree health benefit costs to the Prison Industries Revolving Fund. Prior to fiscal year 2008, the State was on a "pay-as-you-go" allocation and funding policy. Effective with fiscal year 2008, in accordance with the requirements of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions (OPEB)*, the State changed its allocation methodology to recognize the annual required contribution to the plan which is determined by an actuarial valuation which estimates the present value of future retiree healthcare benefits earned.

### ***Liabilities (Continued)***

during the employee's working lifetime, including an amortization of the value of unfunded retiree healthcare benefits attributable to employee service earned in prior fiscal years. The State Controller's Office has determined that CALPIA's annual required OPEB contribution for fiscal 2009 is \$9.4 million. Of this amount, CALPIA contributed \$3.4 million; the balance of \$6.0 million is accrued as a net OPEB long term liability.

At June 30, 2008, the State Controller's Office determined that CALPIA's annual required OPEB contribution for fiscal 2008 was \$10.1 million. Of this amount, CALPIA contributed \$3.5 million; the balance of \$6.6 million was accrued as a net OPEB long term liability.

The \$20.5 million decrease in deferred revenue at June 30, 2009 corresponds principally to the recognition in revenue of a prior year advance received from CDCR for the construction of modular buildings. The \$25.3 million increase in deferred revenue at June 30, 2008 corresponds to a \$25.0 million advance from CDCR for the construction of Modular Buildings.

### **Condensed Statements of Revenues, Expenses and Changes in Net Assets**

The following table presents the condensed statements of revenues, expenses and changes in net assets for the years ended June 30, 2009, 2008 and 2007.

|  | <u>2009</u>           | <u>2008</u>           | <u>2007</u>           |
|--|-----------------------|-----------------------|-----------------------|
| Operating revenues                     | \$ 234,232,997        | \$ 209,531,760        | \$ 205,734,145        |
| Cost of goods sold                     | <u>186,304,080</u>    | <u>170,446,971</u>    | <u>172,170,450</u>    |
| Gross profit                           | 47,928,917            | 39,084,789            | 33,563,695            |
| Selling and administrative expenses    | <u>40,819,994</u>     | <u>42,611,357</u>     | <u>36,550,463</u>     |
| Operating income (loss)                | 7,108,923             | (3,526,568)           | (2,986,768)           |
| Non-operating revenues (expenses), net | <u>(149,785)</u>      | <u>570,697</u>        | <u>2,193,891</u>      |
| Increase (decrease) in net assets      | 6,959,138             | (2,955,871)           | (792,877)             |
| Net assets at beginning of year        | <u>109,220,806</u>    | <u>112,176,677</u>    | <u>112,969,554</u>    |
| Net assets at end of year              | <u>\$ 116,179,944</u> | <u>\$ 109,220,806</u> | <u>\$ 112,176,677</u> |

### ***Operating Revenues - Services and Sales***

As represented in the table below, CALPIA sales increased \$24.7 million (11.8%) in fiscal year 2009 from \$209.5 million to \$234.2 million. Overall, sales in the manufacturing and service enterprises increased by \$16.6 million (15.5%) and \$8.7 million (12.1%), respectively, whereas sales in the agricultural enterprises decreased by \$0.5 million (1.7%). CALPIA sales increased \$3.8 million (1.8%) in fiscal year 2008 from \$205.7 million to \$209.5 million. While manufacturing sales decreased by \$7.0 million (6.1%), sales in the service and agricultural enterprises increased by \$6.0 million (9.1%) and \$4.8 million (18.2%), respectively.

### ***Operating Revenues - Services and Sales (Continued)***

In manufacturing, the combined sales of furniture, metal products, and license plates decreased \$10.4 million (23.2%) in fiscal year 2009. This outcome reflects that state agencies had fewer discretionary funds to spend for the second consecutive year, after CALPIA recorded unprecedented sales levels in these enterprises in fiscal year 2007. Offsetting these decreases, were momentous sales in the modular construction and general fabrication enterprises, whose revenues increased by \$19.4 million (326.5%) and \$4.5 million (35.0%), respectively. These increases are primarily attributable to capital outlay purchases from the CDCR, Department of Transportation, and the Department of Motor Vehicles. Cleaning products revenues also showed a significant increase of \$2.4 million (63.5%), which is a result of expanded marketing of CALPIA's newer cleaning and sanitizing products and their related dispensing systems.

Of the \$8.7 million sales increase in fiscal year 2009 in service enterprises, \$4.9 million (56.8%) occurred in food packaging, \$1.3 million (8.3%) occurred in laundry, and \$1.5 million (16.7%) occurred in the bakery and coffee enterprises. The increases are primarily explained by customer demand for newer products - cookies, peanut butter and jelly, instant coffee, juice products - as well as a full year of price adjustments in the service and agricultural enterprises, which were implemented in the fourth quarter of fiscal year 2008.

The combined sales of metal products, license plates, general fabrication (modular office systems), bindery, fabric products, shoes, and mattresses decreased \$8.2 million in fiscal year 2008 compared to fiscal year 2007. This outcome shows that state agencies had less discretionary funds available during fiscal 2008. The decrease also reflects that CALPIA's manufacturing enterprises experienced unprecedented sales in fiscal 2007, a period in which revenues increased \$19.7 million (21%) over the prior year. In fact, when comparing between fiscal years 2006 and 2008, manufacturing revenues improved \$12.6 million (13.5%).

Of the \$6.0 million sales increase in fiscal year 2008 in service enterprises, \$3.3 million (56.1%) occurred in food packaging sales and \$1.9 million (32.1%) occurred in optical. Food packaging sales increased as a consequence of increased demand for peanut butter and jelly and juice products as well as price adjustments which took effect in the fourth quarter. The increase in optical sales is explained by additional orders for glasses from Caltrans and CDCR in response to the addition of polycarbonate lenses to the product line and increased caseload from Medi-Cal prescriptions.

The \$4.8 million increase in agricultural sales in fiscal year 2008 is mainly attributable to structural price adjustments which were enacted to reflect market conditions in the dairy, poultry, and egg product lines.

***Operating Revenues - Services and Sales (Continued)***

|   | <b>2009</b>    | <b>2008</b>    | <b>2007</b>    |
|---|----------------|----------------|----------------|
| <b>Operating Revenues by Product Line</b> |                |                |                |
| Manufacturing:                            |                |                |                |
| Furniture                                 | \$ 19,547,224  | \$ 24,767,204  | \$ 24,959,996  |
| Metal products                            | 3,908,571      | 6,404,143      | 7,879,859      |
| License plates                            | 10,904,074     | 13,559,436     | 15,486,478     |
| General fabrication                       | 17,226,231     | 12,754,302     | 14,076,625     |
| Bindery                                   | 3,636,349      | 2,959,896      | 3,898,042      |
| Knitting mill                             | 1,785,709      | 2,055,710      | 1,970,862      |
| Fabric products                           | 26,587,531     | 26,918,554     | 28,146,724     |
| Silk screening                            | 54,242         | 73,352         | -              |
| Shoe factory                              | 5,450,382      | 4,497,770      | 5,387,355      |
| Mattress factory                          | 2,598,542      | 2,932,994      | 3,364,628      |
| Cleaning products                         | 6,157,438      | 3,767,089      | 3,716,789      |
| Modular construction                      | 25,328,947     | 5,938,451      | 4,711,299      |
| Total manufacturing                       | 123,185,240    | 106,628,901    | 113,598,657    |
| Services:                                 |                |                |                |
| Meat cutting                              | 10,792,831     | 10,677,467     | 10,398,216     |
| Bakery                                    | 3,442,818      | 2,759,052      | 2,443,014      |
| Coffee roasting                           | 2,305,585      | 1,539,216      | 871,022        |
| Food packaging                            | 16,120,041     | 11,198,080     | 7,853,047      |
| Metal signs                               | 1,324,069      | 1,115,772      | 1,287,191      |
| Printing                                  | 7,573,647      | 7,468,526      | 8,297,085      |
| Dental lab                                | 607,289        | 520,381        | 377,373        |
| Digital services                          | 5,766          | -              | 103,911        |
| Laundry                                   | 16,665,143     | 15,392,253     | 15,000,448     |
| Optical                                   | 21,488,391     | 20,986,880     | 19,072,271     |
| Total services                            | 80,325,580     | 71,657,627     | 65,703,578     |
| Agriculture:                              |                |                |                |
| Dairy/farm                                | 15,193,773     | 15,456,923     | 13,626,191     |
| Crops                                     | 1,341,100      | 1,470,246      | 1,446,137      |
| Poultry                                   | 6,746,286      | 6,290,546      | 5,654,854      |
| Egg production                            | 7,441,018      | 8,027,517      | 5,704,728      |
| Total agriculture                         | 30,722,177     | 31,245,232     | 26,431,910     |
| Total operating revenues                  | \$ 234,232,997 | \$ 209,531,760 | \$ 205,734,145 |

### ***Cost of Goods Sold***

Cost of goods sold increased by \$15.9 million (9.3%) in fiscal year 2009 from \$170.4 million to \$186.3 million. As a percentage of sales, cost of goods sold were 79.5% and 81.3% in fiscal years 2009 and 2008, respectively. The increase in cost of goods sold is the primary consequence of increased sales in the manufacturing enterprises. CALPIA's overall profit margin improved in those areas that experienced the greatest sales increases. Of the total \$8.8 million net increase in gross profit during fiscal year 2009, \$2.6 million was in modular construction, \$1.9 million was in general fabrication, and \$3.6 million was in food packaging.

Cost of goods sold decreased by \$1.7 million (1.0%) in fiscal year 2008 from \$172.1 million to \$170.4 million. As a percentage of sales, cost of goods sold were 81.4% and 83.7% in fiscal years 2008 and 2007, respectively. The decrease in cost of goods sold is the primary consequence of reduced sales in the manufacturing enterprises. Additionally, in certain enterprises, CALPIA reconfigured its product mix or focused sales on more profitable items. For example, "glass" lenses were eliminated from the optical product line, while sales of vertical files decreased in the metal product line, thereby improving the profit margins of those enterprises.

CALPIA undertook a major effort to adjust prices in the latter part of fiscal year 2008, particularly in the service and agricultural enterprises. This effort significantly contributed toward a positive change in profit margin.

### ***Selling and Administrative Expenses***

Selling and administrative expenses decreased by \$1.8 million (4.2%) in fiscal year 2009 from \$42.6 million to \$40.8 million. This decrease is the outcome of a \$1.8 million reduction in distribution and transportation costs. CALPIA achieved this savings due to reduced freight costs associated with fewer sales in the furniture enterprises. Additional savings have been achieved through efficiencies in the distribution program, including increased utilization of CALPIA trucks over common carriers.

Selling and administrative expenses increased by \$6.1 million (16.6%) in fiscal year 2008 from \$36.5 million in fiscal year 2007 to \$42.6 million. This increase is the result of the initial recording of the OPEB obligation in the amount of \$6.6 million. Excluding the effect of the OPEB obligation, CALPIA reduced selling and administrative expenses by \$0.6 million (1.6%) overall.

# CALIFORNIA PRISON INDUSTRY AUTHORITY

## BALANCE SHEETS

June 30, 2009 and 2008

### ASSETS

#### CURRENT ASSETS

|   | <b>2009</b>        | <b>2008</b>        |
|---|--------------------|--------------------|
| Cash and cash equivalents                       | \$ 34,559,867      | \$ 53,045,064      |
| Cash designated for capital assets expenditures | 9,500,000          | 7,162,537          |
| Accounts receivable                             | 5,259,591          | 5,607,497          |
| Related party receivable                        | 5,999,224          | 8,105,517          |
| Inventories                                     | 49,114,484         | 55,832,218         |
| Due from state general fund                     | 20,800,000         | -                  |
| Interest receivable                             | 110,348            | 370,414            |
| Other   | 262,079            | 458,334            |
| Total current assets                            | <u>125,605,593</u> | <u>130,581,581</u> |

|                     |                   |                   |
|---------------------|-------------------|-------------------|
| Capital assets, net | <u>50,307,712</u> | <u>52,552,900</u> |
|---------------------|-------------------|-------------------|

|              |                              |                              |
|--------------|------------------------------|------------------------------|
| TOTAL ASSETS | <u><u>\$ 175,913,305</u></u> | <u><u>\$ 183,134,481</u></u> |
|--------------|------------------------------|------------------------------|

### LIABILITIES AND NET ASSETS

#### CURRENT LIABILITIES

|  |                   |                   |
|--|-------------------|-------------------|
| Accounts payable                       | \$ 10,627,914     | \$ 13,392,202     |
| Accrued expenses and other liabilities | 11,262,835        | 10,786,005        |
| Workers' compensation reserves         | 2,051,832         | 1,210,599         |
| Deferred revenue                       | 10,534,685        | 31,035,693        |
| TOTAL CURRENT LIABILITIES              | <u>34,477,266</u> | <u>56,424,499</u> |

#### LONG TERM LIABILITIES

|                                |                   |                   |
|--------------------------------|-------------------|-------------------|
| Workers' compensation reserves | 12,618,095        | 10,852,176        |
| Net OPEB obligation            | 12,638,000        | 6,637,000         |
| TOTAL LONG TERM LIABILITIES    | <u>25,256,095</u> | <u>17,489,176</u> |

|                   |                   |                   |
|-------------------|-------------------|-------------------|
| TOTAL LIABILITIES | <u>59,733,361</u> | <u>73,913,675</u> |
|-------------------|-------------------|-------------------|

#### NET ASSETS

|                            |                    |                    |
|----------------------------|--------------------|--------------------|
| Invested in capital assets | 50,307,712         | 52,552,900         |
| Unrestricted net assets    | 65,872,232         | 56,667,906         |
| TOTAL NET ASSETS           | <u>116,179,944</u> | <u>109,220,806</u> |

|                                  |                              |                              |
|----------------------------------|------------------------------|------------------------------|
| TOTAL LIABILITIES AND NET ASSETS | <u><u>\$ 175,913,305</u></u> | <u><u>\$ 183,134,481</u></u> |
|----------------------------------|------------------------------|------------------------------|

See Notes to Basic Financial Statements

# CALIFORNIA PRISON INDUSTRY AUTHORITY

## STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

Years Ended June 30, 2009 and 2008

|   | <u>2009</u>                      | <u>2008</u>                      |
|---|----------------------------------|----------------------------------|
| OPERATING REVENUES                          |                                  |                                  |
| Manufacturing                               | \$ 123,185,240                   | \$ 106,628,901                   |
| Services                                    | 80,325,580                       | 71,657,627                       |
| Agriculture                                 | 30,722,177                       | 31,245,232                       |
| TOTAL OPERATING REVENUES                    | <u>234,232,997</u>               | <u>209,531,760</u>               |
| <br>COST OF GOODS SOLD                      | <br><u>186,304,080</u>           | <br><u>170,446,971</u>           |
| GROSS PROFIT                                | <u>47,928,917</u>                | <u>39,084,789</u>                |
| <br>SELLING AND ADMINISTRATIVE EXPENSES     | <br><u>40,819,994</u>            | <br><u>42,611,357</u>            |
| <br>OPERATING INCOME (LOSS)                 | <br><u>7,108,923</u>             | <br><u>(3,526,568)</u>           |
| <br>NON-OPERATING REVENUES (EXPENSES)       |                                  |                                  |
| Interest income                             | 557,436                          | 1,367,022                        |
| Interest expense                            | (30,485)                         | (26,162)                         |
| Loss from disposal of capital assets        | (627,686)                        | (363,693)                        |
| Other expenses                              | (49,050)                         | (406,470)                        |
| <br>TOTAL NON-OPERATING (EXPENSES) REVENUES | <br><u>(149,785)</u>             | <br><u>570,697</u>               |
| <br>Change in net assets                    | <br>6,959,138                    | <br>(2,955,871)                  |
| <br>NET ASSETS - BEGINNING OF YEAR          | <br><u>109,220,806</u>           | <br><u>112,176,677</u>           |
| <br>NET ASSETS - END OF YEAR                | <br><u><u>\$ 116,179,944</u></u> | <br><u><u>\$ 109,220,806</u></u> |

See Notes to Basic Financial Statements

# CALIFORNIA PRISON INDUSTRY AUTHORITY

## STATEMENTS OF CASH FLOWS

Years Ended June 30, 2009 and 2008

| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                            | <b>2009</b>                 | <b>2008</b>                 |
|--|-----------------------------|-----------------------------|
| Cash receipts from customers   | \$ 216,186,189              | \$ 235,519,386              |
| Cash receipts from interfund services provided by the reporting entity | 4,118,278                   | 4,339,550                   |
| Cash payments for interfund services used by the reporting entity      | (10,928,790)                | (9,504,180)                 |
| Cash payments to employees for services                                | (59,159,461)                | (61,753,515)                |
| Cash payments to suppliers of goods and services                       | (139,207,773)               | (131,031,397)               |
| Cash payments for other services                                       | (49,050)                    | (406,470)                   |
| Net cash provided by operating activities                              | <u>10,959,393</u>           | <u>37,163,374</u>           |
| <br><b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>             |                             |                             |
| Due from state general fund  | (20,800,000)                | -                           |
| Interest expense   | (30,485)                    | (26,162)                    |
| Net cash flows used in noncapital financing activities                 | <u>(20,830,485)</u>         | <u>(26,162)</u>             |
| <br><b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>    |                             |                             |
| Acquisitions of capital assets   | (7,735,749)                 | (8,457,151)                 |
| Proceeds from sale of capital assets                                   | 641,605                     | 430,293                     |
| Net cash flows used in capital and related financing activities        | <u>(7,094,144)</u>          | <u>(8,026,858)</u>          |
| <br><b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                        |                             |                             |
| Interest received  | <u>817,502</u>              | <u>1,190,513</u>            |
| <br>Net (decrease) increase in cash and cash equivalents               | (16,147,734)                | 30,300,867                  |
| <br>Cash and cash equivalents at beginning of year                     | <u>60,207,601</u>           | <u>29,906,734</u>           |
| <br>Cash and cash equivalents at end of year                           | <u><u>\$ 44,059,867</u></u> | <u><u>\$ 60,207,601</u></u> |

See Notes to Basic Financial Statements

**CALIFORNIA PRISON INDUSTRY AUTHORITY****STATEMENTS OF CASH FLOWS (CONTINUED)**

Years Ended June 30, 2009 and 2008

|  | <u>2009</u>          | <u>2008</u>          |
|--|----------------------|----------------------|
| Reconciliation of operating income (loss) to net cash provided by operating activities:        |                      |                      |
| Operating income (loss)  | \$ 7,108,923         | \$ (3,526,568)       |
| Adjustments to reconcile operating income (loss) to net cash provided by operating activities: |                      |                      |
| Depreciation   | 8,711,646            | 8,738,829            |
| Other fees   | (49,050)             | (406,470)            |
| Net effect of changes in:  |                      |                      |
| Accounts receivable  | 2,454,199            | 666,142              |
| Inventories  | 6,717,734            | (5,080,994)          |
| Other assets   | 196,255              | 398,714              |
| Accounts payable   | (2,764,288)          | 1,429,090            |
| Accrued expenses and other liabilities   | 476,830              | 1,523,370            |
| Workers' compensation reserves   | 2,607,152            | 1,462,775            |
| Deferred revenue   | (20,501,008)         | 25,321,486           |
| Net OPEB obligation  | 6,001,000            | 6,637,000            |
| Net cash provided by operating activities  | <u>\$ 10,959,393</u> | <u>\$ 37,163,374</u> |

See Notes to Basic Financial Statements

# **CALIFORNIA PRISON INDUSTRY AUTHORITY**

## **Notes to Basic Financial Statements**

For the Fiscal Years Ended June 30, 2009 and 2008

### **(1) ORGANIZATION**

The California Prison Industry Authority ("CALPIA") was established in 1983, as the successor to the California Correctional Industries ("CCI"). It is under the policy direction of an eleven-member board of directors ("Prison Industry Board") and is a component unit of the State of California. CALPIA manages over 60 manufacturing, service, and agriculture factories in 23 institutions that employ inmates at California's penal institutions within the California State Department of Corrections and Rehabilitation ("CDCR"). Administrative offices are located in Folsom, California. The products manufactured by CALPIA's operations are sold principally to departments of the State of California and other governmental entities.

### **(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Basis of accounting* - CALPIA uses the accrual basis of accounting. Under this method, revenues and receivables are recorded when earned, and expenses and liabilities are recorded when incurred.

Governmental Accounting Standards Board Statement No. 20 ("GASB No. 20"), *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, established standards for accounting and financial reporting for proprietary funds. In accordance with GASB No. 20, CALPIA's proprietary fund accounting and financial reporting practices are based on all applicable GASB pronouncements as well as the following pronouncements issued on, or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board ("FASB") Statements and Interpretations, Accounting Principles Board ("APB") Opinions, and Accounting Research Bulletins ("ARB") of the Committee of Accounting Procedures. During the year ended June 30, 2009, CALPIA decided to change its election under GASB No. 20 and has elected not to apply applicable FASB pronouncements issued subsequent to November 30, 1989. Such election was made because the application of FASB pronouncements issued after November 30, 1989 has historically not had a significant impact on CALPIA's financial statements and the State does not apply FASB pronouncements issued after November 30, 1989. Such election has been retroactively applied effective July 1, 2007 and did not have a significant impact on the financial statements.

*Revenue Recognition* - Revenues and receivables are recorded when earned, usually upon the shipment of orders, other than modular furniture and building construction, and expenses and liabilities are recorded when incurred. Revenue on modular furniture and building construction is recognized using the percentage-of-completion method of accounting, in accordance with Statement of Position (SOP) 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*. Under this method, CALPIA recognizes revenue at the end of each period using output measures in terms of results achieved, to measure the extent of progress toward completion under the contract, on the basis of units of work completed.

*Cash and cash equivalents* - Cash consists of deposits in the custody of the State of California Treasurer. CALPIA's deposits are subject to the California Government Code and the State Treasurer's Office investment policy for the Pooled Money Investment Account ("PMIA"). Cash not required for current use is invested in the Surplus Money Investment Fund ("SMIF"), while non-SMIF funds are held in operating accounts, all of which are part of the State Treasurer's pooled investment program.

## CALIFORNIA PRISON INDUSTRY AUTHORITY

Notes to Basic Financial Statements (Continued)  
For the Fiscal Years Ended June 30, 2009 and 2008

### (2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

These funds are invested through the PMIA and at the direction of the Pooled Money Investment Board, which provides regulatory oversight of such funds. PMIA moneys are limited by State statute to the following investments: U.S. governmental securities, securities of federally-sponsored agencies, U.S. corporate bonds, interest-bearing time deposits in California banks and savings and loans, prime-rated commercial paper, bankers' acceptances, negotiable certificates of deposits, and other investments.

The investments in SMIF are reported at amortized cost, which approximates fair value. As of the June 30, 2009 and 2008, the weighted average maturity of PMIA investments administered by the State Treasurer's Office was approximately 235 days and 212 days, respectively. Weighted averaged maturity is the average number of days, given a dollar-weighted value of individual investments, that the securities in the portfolio have remaining from the evaluation date to stated maturity. Neither SMIF nor PMIA are rated.

Interest earned on cash invested in the SMIF and other pooled funds is prorated to CALPIA based on its average daily balance.

At June 30, 2009, \$38,924,000 was invested in SMIF and \$5,135,867 was held in operating accounts in the State Treasury pooled investment program. At June 30, 2008 \$56,752,000 was invested in SMIF and \$3,455,601 was held in operating accounts in the State Treasury pooled investment program. Cash and cash equivalents include cash on hand and temporary cash investments (including SMIF and funds designated for property and equipment acquisitions) with maturities of three months or less.

Governmental Accounting Standards Board Statement No. 40 requires that governmental entities provide disclosures regarding deposit and investment credit risk, custodial credit risk, interest rate risk, and concentration of credit risk. Funds deposited in an external investment pool cannot be categorized under Governmental Accounting Board Statement No. 40 as the funds are commingled with other depositors. Additional information regarding investment risks, including interest rate risk, credit risk and concentration of credit risk of the PMIA can be found in the State's basic financial statements included in its comprehensive annual financial report.

*Cash designated for capital asset expenditures* - CALPIA segregates certain cash which is designated as to use. Designated funds represent designations of cash by the Prison Industry Board for certain capital expenditures.

The Board designated funds amounting to \$9,500,000 and \$7,162,537 for certain capital expenditures to be made during the years ended June 30, 2010 and 2009, respectively.

*Concentrations of credit risk* - Financial instruments which potentially expose CALPIA to concentrations of credit risk consist primarily of trade accounts receivable.

CALPIA's customer base includes departments of the State of California and other governmental entities. CDCR is the largest customer of CALPIA and accounted for approximately 61% and 56% of all sales in the years ended June 2009 and 2008, respectively. As of June 30, 2009 and 2008, CDCR accounted for 53% and 59% of total accounts receivable, respectively. Management does not believe significant credit risk exists at June 2009 and 2008, as the goods and services produced by CALPIA's operations are sold principally to departments of the State of California and other governmental entities.

## CALIFORNIA PRISON INDUSTRY AUTHORITY

Notes to Basic Financial Statements (Continued)

For the Fiscal Years Ended June 30, 2009 and 2008

### (2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

CALPIA and other state and local agencies' deposits are held in the pooled money account in the custody of the State Treasurer's Office, in which the deposits are insured by federal depository insurance or by collateral held by an agent of the State Treasurer's Office in the State's name.

*Accounts receivable* - CALPIA has no formal policy regarding the extension of credit and does not use an allowance for doubtful accounts because their customer base is primarily made up of state and local government agencies. Non-trade receivables are approximately \$465,913 and \$499,323 as of June 2009 and 2008, respectively. Historically, CALPIA has not experienced significant losses related to accounts receivable.

*Due from state general fund* - During the course of normal operations, the State Controller's Office periodically loans funds from CALPIA's deposits held in the custody of the State Treasurer to the state general fund on a short-term basis for cash management reasons. These transactions are reported as "due from state general fund." As of June 30, 2009 and 2008, due from state general fund totaled \$20,800,000 and \$0, respectively.

*Inventories* - Inventories are stated at the lower of cost (as determined using the average cost method) or market. Inventories consist of raw materials, components and subassemblies and finished goods held for sale.

*Capital assets* - Capital assets are stated at historical cost, net of accumulated depreciation. CALPIA has established a threshold of \$5,000 for capitalization of depreciable assets. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The estimated useful lives range from 5 to 20 years for equipment, 5 to 30 years for buildings and leasehold improvements, 2 to 3 years for livestock, and 20 to 25 years for orchards.

Interest expense (net of interest income on unexpended debt proceeds) related to the cost of construction of certain assets is capitalized whenever debt is outstanding and the assets are constructed for use by CALPIA. Capitalized interest is amortized over the related assets' estimated useful lives. Expenditures for repairs and maintenance are charged to operations as incurred.

In the ordinary course of business, CALPIA opens and closes manufacturing facilities based on economic conditions and industry demand for products. Based on CALPIA's closure policy, management may recommend that the factory remain idle if at a later date it is probable that product demand will increase resulting in the factory being reactivated. If management determines not to reactivate a factory, CALPIA will take one of the following actions: (1) determine if the factory has alternative uses, (2) transfer equipment to operating factories, or (3) pursue other alternatives for disposal. Factories which are closed temporarily are retained in the property accounts as idle facilities and are not depreciated during the temporary closure.

For those facilities which have been closed and will be transferred to CDCR, the related assets are transferred at net book value and a gain or loss is recognized upon the transfer.

## CALIFORNIA PRISON INDUSTRY AUTHORITY

Notes to Basic Financial Statements (Continued)

For the Fiscal Years Ended June 30, 2009 and 2008

### (2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

*Asset impairment* - As required by GASB No. 42, management periodically reviews long lived assets for impairments whenever events or changes in circumstances indicate that the service utility of an asset has declined significantly and unexpectedly. If the estimated undiscounted future cash flows are less than the carrying value, a write-down would be recorded to reduce the related asset to its estimated fair value.

*Compensated absences* - It is CALPIA's policy to accrue for personal leave time, holiday pay and vacation pay that has been earned but not yet taken by employees. A liability for compensated absences is accrued when incurred and reported in accrued liabilities on the balance sheet. CALPIA employees are not compensated for unused sick leave, but instead are credited with pension service time for unused sick leave. Accordingly, such convertible sick leave is not reflected in the accrued liability for compensated absences. Instead, it is reflected over time in the employer's pension contribution.

*Deferred revenue* - Deferred revenues represent advance payments from state agencies for the future delivery of products and services.

*Net Assets* - The difference between assets and liabilities in the balance sheet is labeled as Net Assets and is subdivided into two categories as follows:

Invested in capital assets - This component of net assets consists of capital assets, net of accumulated depreciation and amortization.

Unrestricted - This component of net assets consists of net assets not restricted for any project or any other purpose.

*Operating and non-operating activities* - Operating revenues are charges to customers for sales of products and services. Operating expenses consist of cost of sales and selling and administrative expenses. Selling and administrative expenses are comprised of distribution and transportation costs and central office costs. All revenues and expenses not meeting these definitions are reported as non-operating revenues and expenses. Distribution and transportation costs include shipping and handling costs related to the delivery of merchandise sold by CALPIA and for the years ended June 30, 2009 and 2008, were \$13,727,200 and \$15,552,601, respectively.

*Use of estimates in the preparation of financial statements* - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*New accounting pronouncements* - Effective July 1, 2008 CALPIA adopted the provisions of GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* (GASB No. 49.) This statement addresses accounting and reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups.

# CALIFORNIA PRISON INDUSTRY AUTHORITY

Notes to Basic Financial Statements (Continued)

For the Fiscal Years Ended June 30, 2009 and 2008

## (2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Statement established five specified events, which if any one occurs, requires an entity to estimate the expected pollution remediation outlays and determine whether such costs should be recorded as a liability or, if appropriate, capitalized. The adoption of GASB No. 49 did not have a material impact on CALPIA's results of operations, cash flows or financial position.

In March 2009, the GASB issued Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* (GASB No. 55). The new standard is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements of state and local governmental entities that are presented in conformity with GAAP, which were previously set forth in the auditing standards of the American Institute of Certified Public Accountants (AICPA.) The adoption of GASB No. 55 did not have a material impact on CALPIA's financial position, results of operations or cash flows.

In March 2009, the GASB issued Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards* (GASB No. 56). The statement establishes accounting and financial reporting standards for related party transactions, subsequent events, and going concern consideration for state and local governments. This statement does not establish new accounting standards but rather incorporates the existing guidance to the extent appropriate in a government environment into the GASB standards. The adoption of GASB No. 56 did not have a material impact on CALPIA's financial position, results of operations or cash flows.

*Reclassifications* - Certain reclassifications were made to the June 30, 2008 financial statements to conform to the presentation of the June 30, 2009 financial statements.

## (3) INVENTORIES

Inventories consist of the following:

|                   | June 30,     |              |
|-------------------|--------------|--------------|
|                   | 2009         | 2008         |
| Raw materials     | \$28,265,029 | \$30,177,379 |
| Work-in-process   | 11,346,193   | 12,324,373   |
| Finished goods    | 9,503,262    | 13,330,466   |
| Total inventories | \$49,114,484 | \$55,832,218 |

# CALIFORNIA PRISON INDUSTRY AUTHORITY

Notes to Basic Financial Statements (Continued)  
For the Fiscal Years Ended June 30, 2009 and 2008

## (4) CAPITAL ASSETS

A summary of changes in capital assets during fiscal years 2009 and 2008 is as follows:

|  | <b>Balance<br/>June 30, 2008</b> | <b>Additions</b>   | <b>Deletions</b>     | <b>Balance<br/>June 30, 2009</b> |
|--|----------------------------------|--------------------|----------------------|----------------------------------|
| Equipment  | \$108,059,631                    | \$4,904,875        | \$(4,433,757)        | \$108,530,749                    |
| Buildings and leasehold improvements, net of transfers | 37,607,055                       | 646,958            | (168,973)            | 38,085,040                       |
| Livestock  | 5,117,354                        | 2,232,706          | (2,075,000)          | 5,275,060                        |
| Orchards   | 923,506                          | (48,790)           | -                    | 874,716                          |
| <b>Total</b>   | <b>151,707,546</b>               | <b>7,735,749</b>   | <b>(6,677,730)</b>   | <b>152,765,565</b>               |
| Accumulated depreciation and amortization              | (99,154,646)                     | (8,711,646)        | 5,408,439            | (102,457,853)                    |
| <b>Capital assets, net</b>                             | <b>\$52,552,900</b>              | <b>\$(975,897)</b> | <b>\$(1,269,291)</b> | <b>\$50,307,712</b>              |

|  | <b>Balance<br/>June 30, 2007</b> | <b>Additions</b>   | <b>Deletions</b>   | <b>Balance<br/>June 30, 2008</b> |
|--|----------------------------------|--------------------|--------------------|----------------------------------|
| Equipment  | \$104,258,103                    | \$4,995,015        | \$(1,193,487)      | \$108,059,631                    |
| Buildings and leasehold improvements, net of transfers | 36,013,415                       | 1,593,640          | -                  | 37,607,055                       |
| Livestock  | 5,215,557                        | 1,868,497          | (1,966,700)        | 5,117,354                        |
| Orchards   | 923,506                          | -                  | -                  | 923,506                          |
| <b>Total</b>   | <b>146,410,581</b>               | <b>8,457,152</b>   | <b>(3,160,187)</b> | <b>151,707,546</b>               |
| Accumulated depreciation and amortization              | (92,782,018)                     | (8,738,828)        | 2,366,200          | (99,154,646)                     |
| <b>Capital assets, net</b>                             | <b>\$53,628,563</b>              | <b>\$(281,676)</b> | <b>\$(793,987)</b> | <b>\$52,552,900</b>              |

Depreciation expense for the years ended June 30, 2009 and 2008 was \$8,711,646 and \$8,738,828, respectively.

# CALIFORNIA PRISON INDUSTRY AUTHORITY

Notes to Basic Financial Statements (Continued)  
For the Fiscal Years Ended June 30, 2009 and 2008

## (5) ACCRUED EXPENSES AND OTHER LIABILITIES

|                                     | June 30,            |                     |
|-------------------------------------|---------------------|---------------------|
|                                     | 2009                | 2008                |
| Accrued leave time                  | \$8,142,997         | \$7,925,721         |
| Support charges due to CDCR         | 2,096,898           | 1,636,503           |
| Inmate pay                          | 369,246             | 402,132             |
| Personal services                   | 334,548             | 397,060             |
| Sales and use tax                   | 255,057             | 347,332             |
| Accrued service and expenses        | 64,089              | 77,257              |
|                                     | <u>\$11,262,835</u> | <u>\$10,786,005</u> |
| Total accrued and other liabilities | <u>\$11,262,835</u> | <u>\$10,786,005</u> |

## (6) WORKERS' COMPENSATION RESERVES

CALPIA is exposed to risk of loss related to torts, theft of, damage to, and destruction of assets, injuries to employees, and natural disasters. The State of California self-insures its workers' compensation claims. CALPIA's workers' compensation claims are administered by the State Compensation Insurance Fund as part of the overall State program. CALPIA currently reports claims, expenditures and liabilities when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported and related loss adjustment expenses. Consulting actuaries assist CALPIA in determining its liability for workers' compensation self-insured claims.

The amount of these liabilities was a discounted value of \$14,669,927 and \$12,062,775 at June 30, 2009 and 2008, respectively. The interest rates used to discount the value of the liabilities for the years ended June 30, 2009 and 2008, were 3.5% and 5.0%, respectively. This liability represents CALPIA's best estimate of its ultimate exposure based on available actuarial information.

| Fiscal<br>Year | Beginning of<br>Fiscal Year<br>Liability | Current<br>Year<br>Claims and<br>Changes in<br>Estimates | Claims<br>Payments | Legal and<br>Administrative<br>Expenses<br>Paid | End of<br>Fiscal Year<br>Liability |
|----------------|--|--|--------------------|---|------------------------------------|
| 2008-2009      | \$12,062,775                             | \$4,658,982  | \$(1,609,324)      | \$(442,508)                                     | \$14,669,927                       |
| 2007-2008      | \$10,600,000                             | \$2,986,201  | \$(1,210,599)      | \$(312,827)                                     | \$12,062,775                       |

## (7) DEFINED BENEFIT PENSION PLAN

*Plan description* - The State is a member of the California Public Employee's Retirement System ("CalPERS"), an agent multiple-employer pension system, which provides a contributory defined-benefit pension for substantially all State employees. CALPIA is included in the State Industrial and Safety Categories within CalPERS, thereby limiting the availability of certain CALPIA pension data. CalPERS functions as an investment and administrative agent for participating public agencies within the State of California. CalPERS has the authority to establish and amend the benefit provisions of the plan. Departments and agencies within the State of California, including CALPIA, are in a cost-sharing arrangement in which all risks and costs are shared proportionately by participating State agencies.

## CALIFORNIA PRISON INDUSTRY AUTHORITY

Notes to Basic Financial Statements (Continued)

For the Fiscal Years Ended June 30, 2009 and 2008

### (7) DEFINED BENEFIT PENSION PLAN (CONTINUED)

CalPERS issues a publicly available Comprehensive Annual Financial Report that includes financial statements and required supplementary information for CalPERS. A copy of that report may be obtained by writing CalPERS, Central Supply, P.O. Box 942715, Sacramento, California 94229-2705, or by logging onto the CalPERS web site at [www.calpers.ca.gov/](http://www.calpers.ca.gov/).

The pension plan provides retirement benefits, survivor benefits, and death and disability benefits based upon employee's years of credited service, age and final compensation. Vesting occurs after five years of credited service except for second tier benefits, which require 10 years of credited service. Employees who retire at or after 50 with five or more years of service are entitled to a retirement benefit, payable monthly for the remainder of their lives. Several survivors benefit options which reduce a retiree's unmodified benefit are available.

*Funding policy* - Active members who participate in Social Security under the State Industrial Tier 1 category are required to contribute 5% of their annual covered salary after excluding the first \$513 of gross monthly pay. Active members who do not participate in Social Security under the State Safety & Industrial Tier 1 categories are required to contribute 6% of their annual covered salary after excluding the first \$317 of gross monthly pay. Active members who participate in Social Security under the State Industrial Tier 2 category are not required to make contributions to CalPERS.

CALPIA is required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the CalPERS Board of Administration. The required employer contribution rate for the year ended June 30, 2009 was 17.236% and 18.411% for State Industrial and Safety categories, respectively. The required employer contribution rate for the year ended June 30, 2008 was 17.345% and 18.835% for State Industrial and Safety categories, respectively. The contribution requirements of the plan members are established by State statute and the employer contributions rate is established and may be amended by CalPERS.

*Annual pension costs* - For the years ended June 30, 2009, 2008 and 2007, CALPIA's annual pension cost and CALPIA's actual contribution amounted to \$6,078,739, \$6,501,948, and \$6,566,157 respectively. The required contribution for State Industrial and Safety categories for the 2009 fiscal year was determined as part of the June 30, 2007, actuarial valuation using the entry age normal actuarial cost method with the contributions determined as a percent of pay. The actuarial assumptions included (a) 7.75% investment rate of return (net of administrative expenses), (b) projected salary increases that vary by duration of service ranging from 3.25 to 9.55%, (c) 3.25% overall payroll growth, and (d) 3.0% inflation adjustment.

The actuarial value of CALPIA's assets was determined using a technique that smoothes the effect of short-term volatility in the market value of investments over a 15 year period. The plan's unfunded actuarial accrued liability (or excess assets) is being amortized as a level of percentage of projected payroll on a closed basis. The remaining amortization periods at June 30, 2008 the date of the most recent actuarial valuation, were 15 to 30 years for both the State Industrial Plans and the State Safety Plans.

# CALIFORNIA PRISON INDUSTRY AUTHORITY

Notes to Basic Financial Statements (Continued)

For the Fiscal Years Ended June 30, 2009 and 2008

## (8) POSTEMPLOYMENT BENEFITS OTHER THAN PENSION

*Plan description* - CALPIA employees are employees of the State of California (the State). Consequently, CALPIA employees participate in the State pension and other postemployment benefit (OPEB) plans. The State OPEB plan is a single-employer defined benefit plan. A separate actuarial valuation was not performed for CALPIA. The State's OPEB plan does not issue a separate report.

The State provides medical, prescription drug, and dental benefits (healthcare benefits) to retired statewide employees. The authority for establishing and amending benefits lies with CalPERS and the State Legislature while the authority for establishing and amending the funding policy lies solely with the Legislature.

*Funding policy* - The State has historically been on a "pay-as-you-go" funding and allocation policy; however, pursuant to the requirements of GASB No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, effective for fiscal year 2008, the State amended its allocation methodology to include amortization of its accumulated unfunded postemployment obligations. The State has determined CALPIA's June 30, 2009 and 2008 funding requirements as well as its related 2009 and 2008 contribution credit. The amount allocated to CALPIA at June 30, 2009 and 2008 representing the annual OPEB cost was \$9,422,000 and \$10,086,000 respectively. Of this amount, \$3,421,000 was contributed for 2009 and the balance of \$6,001,000 was accrued as a liability. The contribution made for 2008 was \$3,449,000 and the balance of \$6,637,000 was accrued as a liability.

*Annual OPEB cost and Net OPEB obligation* - The State of California's annual other postemployment benefit cost is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined by the State in accordance with the parameters of GASB No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. The State determines the allocation for CALPIA based upon the relationship of active employee health benefit costs for CALPIA as compared to the total State active employee health benefit costs. The following table shows the components of CALPIA's allocation of the State's annual OPEB cost for the year, the amount credited to the plan, and changes in the net OPEB obligation as of June 30, 2009:

|  |                     |
|--|---------------------|
| Annual required contribution               | \$9,389,000         |
| Interest on net OPEB obligation            | 267,000             |
| Adjustment to annual required contribution | (234,000)           |
| Annual OPEB cost (expense)                 | <u>9,422,000</u>    |
| Contributions made                         | <u>(3,421,000)</u>  |
| Increase in net OPEB obligation            | 6,001,000           |
| Net OPEB obligation - beginning of year    | <u>6,637,000</u>    |
| Net OPEB obligation - end of year          | <u>\$12,638,000</u> |

**CALIFORNIA PRISON INDUSTRY AUTHORITY**

Notes to Basic Financial Statements (Continued)

For the Fiscal Years Ended June 30, 2009 and 2008

**(8) POSTEMPLOYMENT BENEFITS OTHER THAN PENSION (CONTINUED)**

CALPIA's allocation of the annual OPEB cost, the percentage of annual OPEB costs contributed to the plan, and the net OPEB obligation for 2009 and 2008 were as follows:

| <b>Fiscal Year<br/>Ended June<br/>30,</b> | <b>Annual<br/>OPEB Cost</b> | <b>Percentage of<br/>Annual OPEB<br/>Cost<br/>Contributed</b> | <b>Net OPEB<br/>Obligation</b> |
|---|-----------------------------|---|--------------------------------|
| 2009                                      | \$9,422,000                 | 36.3%   | \$12,638,000                   |
| 2008                                      | \$10,086,000                | 34.2%   | \$6,637,000                    |

Based on information provided to CALPIA by the State of California, in the June 30, 2008 actuarial valuation, the individual entry-age normal cost method was used. A pay-as-you go funding scenario was used by the State of California. Under the pay-as-you-go funding scenario, the State is assumed to finance retiree healthcare benefits from assets available in the general fund. The State's actuarial assumptions included a 4.5% investment rate of return and an annual healthcare cost trend rate of actual increases for 2009 and of 8.5% in 2010, initially, decreasing each year over the next seven years until the ultimate rate of 4.5% is reached. Both rates included a 3.0% annual inflation assumption. Annual wage inflation is assumed to be 3.25%. The UAAL is being amortized as a level percentage of projected payroll on an open basis over thirty years.

The schedule of funding progress and employer contributions for the State of California for the year ended June 30, 2009 can be found in the State's basic financial statements included in its comprehensive annual financial report.

**(9) RELATED PARTY TRANSACTIONS**

Related party transactions with CDCR consisted of the follow for fiscal ended June 30:

|  | <b>2009</b> | <b>2008</b>  |
|--|-------------|--------------|
| Assets:                                |             |              |
| Accounts receivable                    | \$5,999,224 | \$8,105,517  |
| Liabilities:                           |             |              |
| Accrued expenses and other liabilities | (2,096,898) | (1,636,503)  |
| Deferred revenue                       | (5,780,714) | (26,030,015) |
| Revenues:                              |             |              |
| Sales                                  | 142,908,536 | 116,398,550  |
| Expenses:                              |             |              |
| Support charges paid                   | (5,532,902) | (5,882,500)  |

The secretary of CDCR is the chairman of the Prison Industry Board. The accounts receivable is for the sale of goods and services delivered to CDCR. The accrued expenses and other liabilities represent expenses incurred for rent and utilities associated with the space owned by CDCR, and used by CALPIA to operate the inmate work programs. The deferred revenue primarily consists of payments received in advance of delivery of goods and services for modular buildings construction.

# CALIFORNIA PRISON INDUSTRY AUTHORITY

Notes to Basic Financial Statements (Continued)

For the Fiscal Years Ended June 30, 2009 and 2008

## (9) RELATED PARTY TRANSACTIONS (CONTINUED)

CALPIA has transactions with other agencies of the state of California in addition to CDCR. As of June 30, 2009 and 2008, CALPIA had accounts receivable from other state agencies of \$4,440,943 and \$4,415,681, respectively.

## (10) CONTINGENCIES

*Litigation* - Three California state employees' unions (CASE, SEIU and IUOE) have filed civil actions challenging the legality of the furloughs imposed on state employees by Governor Schwarzenegger, that went into effect in February 2009. The petition filed by the plaintiffs allege that the furloughs were imposed in violation of state law and that the Governor lacked the authority to impose the furloughs on the employees. The court is expected to issue a written decision by the end of December 2009 on the legal proceedings pending against various state agencies, including CALPIA, brought by the above plaintiffs. A potentially material loss contingency is reasonably possible, based on the current assessment by CALPIA management and its legal counsel's evaluation. CALPIA estimates its exposure to this litigation is approximately \$5,077,000.

CALPIA is involved in various other legal actions arising in the ordinary course of business. In the opinion of management, after consulting with legal counsel, CALPIA intends to defend these cases vigorously and believes that the ultimate liability, if any, will not be material to the financial position of CALPIA.

## (11) COMMITMENTS

*Warranties* - CALPIA provides a warranty on its office and miscellaneous furniture and bedding products for a period of five years. CALPIA has not established a reserve for warranty expense. The affect on operations are deemed by management to be immaterial and costs are expensed when incurred.

*Rental payments* - Future minimum rental payments required under operating leases that have initial or remaining noncancellable lease terms in excess of one year and expiring in 2015 as of June 30, 2009, are as follows:

| <u>Fiscal Year</u><br><u>Ended June 30,</u> | <u>Real Estate</u> |
|---|--------------------|
| 2010  | \$685,232          |
| 2011  | 174,894            |
| 2012  | 204,132            |
| 2013  | 204,132            |
| 2014  | 204,132            |
| Thereafter                                  | 187,121            |
| Total                                       | <u>\$1,659,643</u> |

Total rental expense for all operating leases except those with terms of a month or less that were not renewed was \$770,993 and \$800,411 for the years ended June 30, 2009 and 2008, respectively.

**CALIFORNIA PRISON INDUSTRY AUTHORITY**

Notes to Basic Financial Statements (Continued)  
For the Fiscal Years Ended June 30, 2009 and 2008

**( 12 )    SUBSEQUENT EVENTS**

Subsequent to June 30, 2009 CALPIA management closed two of its optical factories, a dairy operation, and deactivated two furniture factories, but does not expect the impairment to be material to results of operations.

## **ADDITIONAL INFORMATION**



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**NEWPORT BEACH**

**SAN DIEGO**

## **INDEPENDENT AUDITORS' REPORT ON SUPPLEMENTAL INFORMATION**

To the California Prison Industry Authority Board  
Folsom, California

We have audited the basic financial statements of California Prison Industry Authority ("CALPIA") as of and for the year ended June 30, 2009 and have issued our report thereon dated December 1, 2009. Our audit was conducted for the purpose of forming an opinion on the basic financial statements. The supplemental Balance Sheet, Statement of Revenues, Expenses and Changes in Net Assets, and Statement of Cash Flows as of and for the year ended June 30, 2009, classified, in accordance with the State Controller's Office Instructions (collectively the "SCO financial statements") are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

A handwritten signature in black ink that reads "Macias Gini &amp; O'Connell LLP". The signature is written in a cursive, flowing style.

Sacramento, California  
December 1, 2009

**CALIFORNIA PRISON INDUSTRY AUTHORITY  
INTERNAL SERVICE FUND**

**BALANCE SHEETS  
CLASSIFIED IN ACCORDANCE WITH THE STATE CONTROLLER'S INSTRUCTIONS**

June 30, 2009 and 2008  
(in thousands)

|  | <u>A S S E T S</u> |                   |
|--|--------------------|-------------------|
|  | <u>2009</u>        | <u>2008</u>       |
| <b>CURRENT ASSETS</b>  |                    |                   |
| Cash and pooled investments                                    | \$ 44,060          | \$ 60,209         |
| Receivables, (net)   | 2,051              | 4,178             |
| Due from other funds   | 29,829             | 9,602             |
| Due from other governments                                     | 289                | 302               |
| Prepaid items  | 262                | 458               |
| Inventories, at cost   | 49,114             | 55,832            |
| <b>TOTAL CURRENT ASSETS</b>                                    | <u>125,605</u>     | <u>130,581</u>    |
| <b>NONCURRENT ASSETS</b>                                       |                    |                   |
| Depreciable capital assets:                                    |                    |                   |
| Buildings  | 6,053              | 6,037             |
| Leasehold improvements   | 32,032             | 31,570            |
| Equipment  | 108,531            | 108,060           |
| Livestock  | 5,275              | 5,117             |
| Orchards   | 875                | 924               |
| <b>TOTAL CAPITAL ASSETS</b>                                    | <u>152,766</u>     | <u>151,708</u>    |
| Accumulated depreciation:                                      |                    |                   |
| Buildings  | (2,991)            | (2,757)           |
| Leasehold improvements   | (21,977)           | (20,696)          |
| Equipment  | (76,012)           | (74,286)          |
| Livestock  | (889)              | (871)             |
| Orchards   | (589)              | (545)             |
| <b>TOTAL ACCUMULATED DEPRECIATION</b>                          | <u>(102,458)</u>   | <u>(99,155)</u>   |
| <b>TOTAL NONCURRENT ASSETS</b>                                 | <u>50,308</u>      | <u>52,553</u>     |
| <b>TOTAL ASSETS</b>  | <u>\$ 175,913</u>  | <u>\$ 183,134</u> |
| <br><u>L I A B I L I T I E S   A N D   N E T   A S S E T S</u> |                    |                   |
| <b>CURRENT LIABILITIES</b>                                     |                    |                   |
| Accounts payable and other                                     | \$ 11,395          | \$ 14,194         |
| Due to other funds   | 2,352              | 2,058             |
| Deferred revenue   | 10,535             | 31,036            |
| Compensated absences payable                                   | 8,143              | 7,926             |
| Other current liabilities                                      | 2,052              | 1,211             |
| <b>TOTAL CURRENT LIABILITIES</b>                               | <u>34,477</u>      | <u>56,425</u>     |
| <b>NONCURRENT LIABILITIES</b>                                  |                    |                   |
| Net OPEB obligation  | 12,638             | 6,637             |
| Other non-current liabilities                                  | 12,618             | 10,852            |
| <b>TOTAL NONCURRENT LIABILITIES</b>                            | <u>25,256</u>      | <u>17,489</u>     |
| <b>TOTAL LIABILITIES</b>                                       | <u>59,733</u>      | <u>73,914</u>     |
| <b>NET ASSETS</b>  |                    |                   |
| Invested in capital assets                                     | 50,308             | 52,554            |
| Unrestricted net assets  | 65,872             | 56,666            |
| <b>TOTAL NET ASSETS</b>  | <u>116,180</u>     | <u>109,220</u>    |
| <b>TOTAL LIABILITIES AND NET ASSETS</b>                        | <u>\$ 175,913</u>  | <u>\$ 183,134</u> |

**CALIFORNIA PRISON INDUSTRY AUTHORITY**  
**INTERNAL SERVICE FUND**

**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS**  
**CLASSIFIED IN ACCORDANCE WITH THE STATE**  
**CONTROLLER'S INSTRUCTIONS**

Years Ended June 30, 2009 and 2008  
(in thousands)

| OPERATING REVENUES                         | <u>2009</u>              | <u>2008</u>              |
|--|--------------------------|--------------------------|
| Services and sales                         | <u>\$ 234,233</u>        | <u>\$ 209,532</u>        |
| <br>OPERATING EXPENSES                     |                          |                          |
| Personal services                          | (68,019)                 | (69,915)                 |
| Supplies                                   | (3,203)                  | (3,686)                  |
| Services and charges                       | (147,190)                | (130,719)                |
| Depreciation                               | <u>(8,712)</u>           | <u>(8,739)</u>           |
| Total operating expenses                   | <u>(227,124)</u>         | <u>(213,059)</u>         |
| <br>OPERATING INCOME (LOSS)                | <u>7,109</u>             | <u>(3,527)</u>           |
| <br>NONOPERATING REVENUES (EXPENSES)       |                          |                          |
| Interest income                            | 557                      | 1,367                    |
| Interest expense                           | (30)                     | (26)                     |
| Loss on disposal of capital assets         | (628)                    | (364)                    |
| Other expense                              | <u>(49)</u>              | <u>(406)</u>             |
| <br>Total nonoperating (expenses) revenues | <u>(150)</u>             | <u>571</u>               |
| <br>Change in net assets                   | 6,959                    | (2,956)                  |
| <br>NET ASSETS AT BEGINNING OF YEAR        | <u>109,221</u>           | <u>112,177</u>           |
| <br>NET ASSETS AT END OF YEAR              | <u><u>\$ 116,180</u></u> | <u><u>\$ 109,221</u></u> |

**CALIFORNIA PRISON INDUSTRY AUTHORITY  
INTERNAL SERVICE FUND**

**STATEMENTS OF CASH FLOWS  
CLASSIFIED IN ACCORDANCE WITH THE STATE  
CONTROLLER'S INSTRUCTIONS**

Years Ended June 30, 2009 and 2008  
(in thousands)

|  | <u>2009</u>      | <u>2008</u>      |
|--|------------------|------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                            |                  |                  |
| Receipts from customers  | \$ 216,186       | \$ 235,519       |
| Receipts from interfund services provided                              | 4,118            | 4,339            |
| Payments for interfund services used                                   | (10,929)         | (9,504)          |
| Payments to employees  | (59,159)         | (61,754)         |
| Payments to suppliers  | (139,208)        | (131,031)        |
| Payments for other services  | (49)             | (406)            |
| <b>Net cash provided by operating activities</b>                       | <u>10,959</u>    | <u>37,163</u>    |
| <b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>                 |                  |                  |
| Change in interfund receivable   | (20,800)         | -                |
| Interest expense   | (30)             | (26)             |
| <b>Net cash flows used in noncapital financing activities</b>          | <u>(20,830)</u>  | <u>(26)</u>      |
| <b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>        |                  |                  |
| Acquisitions of capital assets   | (7,736)          | (8,457)          |
| Proceeds from sale of capital assets                                   | 642              | 430              |
| <b>Net cash flows used in capital and related financing activities</b> | <u>(7,094)</u>   | <u>(8,027)</u>   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                            |                  |                  |
| Interest on investments  | <u>817</u>       | <u>1,190</u>     |
| Net (decrease) increase in cash and pooled investments                 | (16,148)         | 30,301           |
| Cash and pooled investments, beginning of year                         | 60,208           | 29,907           |
| Cash and pooled investments, end of year                               | <u>\$ 44,060</u> | <u>\$ 60,208</u> |

**CALIFORNIA PRISON INDUSTRY AUTHORITY  
INTERNAL SERVICE FUND**

**STATEMENTS OF CASH FLOWS  
CLASSIFIED IN ACCORDANCE WITH THE STATE  
CONTROLLER'S INSTRUCTIONS**

Years Ended June 30, 2009 and 2008  
(in thousands)

| <b>RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH<br/>PROVIDED BY (USED IN) OPERATING ACTIVITIES</b> | <b>2009</b>      | <b>2008</b>      |
|---|------------------|------------------|
| Operating income (loss)   | \$ 7,109         | \$ (3,527)       |
| Adjustments to reconcile operating income (loss) to net cash<br>provided by operating activities:           |                  |                  |
| Depreciation  | 8,712            | 8,739            |
| Other fees  | (49)             | (406)            |
| Net effect of changes in:   |                  |                  |
| Receivables   | 2,127            | (2,757)          |
| Due from other funds  | 314              | 3,276            |
| Due from other governments  | 13               | 149              |
| Prepaid items   | 196              | 399              |
| Inventories   | 6,718            | (5,081)          |
| Accounts payable and other  | (2,799)          | 1,432            |
| Due to other funds  | 294              | 1,760            |
| Deferred revenue  | (20,501)         | 25,321           |
| Other current liabilities   | 841              | (224)            |
| Compensated absences payable  | 217              | (240)            |
| Other liabilities   | 7,767            | 8,322            |
| Total adjustments   | 3,850            | 40,690           |
| Net cash provided by operating activities   | <u>\$ 10,959</u> | <u>\$ 37,163</u> |



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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN  
AUDIT OF FINANCIAL STATEMENTS PERFORMED  
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

To the California Prison Industry Authority Board  
Folsom, California

We have audited the basic financial statements of California Prison Industry Authority ("CALPIA") as of and for the year ended June 30, 2009 and have issued our report thereon dated December 1, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered CALPIA's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of CALPIA's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of CALPIA's internal control over financial reporting.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we considered to material weaknesses, as defined above.

## Compliance and Other Matters

As part of obtaining reasonable assurance about whether CALPIA's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain other matters that we will report to management of CALPIA in a separate letter.

This report is intended solely for the information and use of management, the Prison Industry Authority Board, and others within CALPIA, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Macier Gini & O'Connell LLP". The signature is written in a cursive, flowing style.

Sacramento, California  
December 1, 2009